

**LEGISLATIVE SERVICES AGENCY
OFFICE OF FISCAL AND MANAGEMENT ANALYSIS**

200 W. Washington, Suite 301
Indianapolis, IN 46204
(317) 233-0696
<http://www.in.gov/legislative>

FISCAL IMPACT STATEMENT

LS 7080

BILL NUMBER: SB 269

NOTE PREPARED: Jan 23, 2004

BILL AMENDED: Jan 22, 2004

SUBJECT: State and Local Operating Expenditure Cap

FIRST AUTHOR: Sen. Miller

FIRST SPONSOR:

BILL STATUS: CR Adopted - 1st House

FUNDS AFFECTED: X GENERAL
X DEDICATED
FEDERAL

IMPACT: State & Local

Summary of Legislation: This bill limits increases in operating expenditures of the state and political subdivisions to the rate of inflation. The bill provides several exceptions. This bill also provides for the deposit of revenues exceeding the operating expenditure limit in an entity's rainy day fund and requires a specified percentage of the excess revenues to be used for property tax relief and makes related changes.

Effective Date: July 1, 2004.

Explanation of State Expenditures: *Expenditure Limits:* This bill establishes a maximum annual percentage change for state government operating expenditures to be based on the sum of the percentage changes in inflation (defined as the percentage change in the Consumer Price Index, or CPI, for the preceding calendar year). The bill defines operating expenses to include: (1) personal services, including payments for salaries and wages, payments for compensation awards, and the employer's share of Social Security, health insurance, life insurance, disability insurance, and retirement fund contributions; (2) supplies, materials, and parts; (3) grants, subsidies, refunds, and awards; (4) travel; (5) machinery, implements, tools, furniture, furnishings, vehicles, and other articles that have a calculable period of service that exceeds 12 months; (6) other administrative expenses; and (7) services other than personal services.

The operating expense limit does not apply to the following: (1) capital; (2) transfers of money among the General Fund (GF), Property Tax Replacement Fund (PTRF), and Rainy Day Fund (RDF); (3) reserve fund deposits; (4) refunds of intergovernmental transfers; (5) payments of judgements and settlements; (6) distributions to local units of government; (7) motor vehicle excise tax replacement payments; and (8) federal funds or designated gifts.

The operating expenditure limit applies to all state agencies. State agencies include: (1) all offices, officers,

boards, commissions, departments, divisions, bureaus, committees, agencies, authorities, councils, or other instrumentalities of the state: (2) all hospitals, penal institutions, and other institutional enterprises of the state; (3) the judiciary; and (4) the legislative branch.

The operating expenditure limit equals the sum of the expenditures made in the immediately preceding year plus encumbrances, multiplied by the inflation multiplier.

NOTE: The bill creates another expenditure limit in addition to the expenditure limit set out in P.L. 192-2002(ss). P.L. 192-2002(ss) established a maximum annual percentage change for state government expenditures to be based on the percentage change in Indiana nonfarm personal income over the last six calendar years or 6% beginning in FY 2006. The expenditure limit for FY 2004 and FY 2005 was 3.5%. The expenditure limit set out in P.L. 192-2002(ss) was restricted to expenditures from the General Fund, the Property Tax Replacement Fund, and the Rainy Day Fund, but it also included capital expenditures. This bill would apply to all funds, including dedicated funds. However, it does not apply to federal funds or capital expenditures.

If revenues exceed the operating expenditure limit, the excess shall be deposited in the Rainy Day Fund. If a transfer is made from the Rainy Day Fund to the Property Tax Replacement Fund, due to the RDF reaching its cap of 7% of General Fund revenue, the bill directs a portion of the revenue transferred to be used for additional property tax relief. The amount that is to be used for new property tax relief would be the amount of the transfer that exceeds 10% of the total General Fund revenue.

The bill allows individuals to file a lawsuit to enforce the state expenditure limits. Successful plaintiffs are allowed costs and reasonable attorney fees. The state may recover costs and reasonable attorney fees if a suit is ruled frivolous.

This bill applies to appropriations beginning in FY 2006.

The impact on state spending and the amount of revenue which would be available for refund is subject to legislative, executive, and judicial actions.

Background Information: The average annual changes in the CPI for the last four years are identified below.

<u>Calendar Year</u>	<u>% Change CPI</u>
1999	2.19%
2000	3.37%
2001	2.83%
2002	1.59%

The Rainy Day Fund Balance as of June 30, 2003, was \$278.5 M. The maximum fund balance (or 7% of General Fund Revenue) was \$509.3 M. According to the January 12, 2004, Reserve Statement, the Rainy Day Fund Balance is anticipated to be \$0 at the end of FY 2005.

According to the January 12, 2004, *Reserve Statement*, FY 2004 budgeted appropriations for the GF and the PTRF are \$11,280.7 M and FY 2005 appropriations are \$11,505.8 M, for an increase of 2.5%. Estimated

appropriations and expenditures, before payment delays and reversions, are projected to be \$11,502 M in FY 2004 and \$11,665.3 M in FY 2005, for an increase of 1.4%. The average annual change in CPI for the last four years has been 2.5%. The spending limitation under current statute (IC 4-10-21) is 3.5% for FY 2005.

The January 2004 revenue forecast projects a 6.9% increase in General Fund and Property Tax Replacement Fund revenue for FY 2004, due to increased gaming and sales taxes, and a 4.2% increase for FY 2005. The projected percentage increase in revenue adjusted for the tax increases passed by the 2002 legislature is 2.2% for FY 2004 and 4.7% for FY 2005. There is no official forecast of GF and PTRF revenue collections for FY 2006 and beyond. There is also no forecast of other dedicated fund revenues.

Property Tax Replacement Credits (PTRC) and Homestead Credit: If a taxing unit chooses to reduce property tax levies as a result of the operating expenditure limits discussed below in *Local Expenditures*, the state would have reduced liabilities for PTRC and the Homestead Credit. Since Homestead Credit is paid against the net tax bill after PTRC is applied, Homestead Credit expense would also be reduced if additional PTRC is paid by the state as a result of excess state revenues and the RDF cap. PTRC and Homestead Credits are paid from the Property Tax Replacement Fund which is annually supplemented by the state General Fund. Any savings of PTRC and Homestead Credit expenditures would ultimately benefit the state General Fund.

Explanation of State Revenues:

Explanation of Local Expenditures: Beginning in CY 2005, a local civil unit's expenditures for operating expenses would be limited. The limit would be equal to the percentage change in CPI from the previous year plus an additional 1% if the change in the unit's assessed value from the previous year exceeds the statewide assessed value change by at least 2%. Under certain conditions, taxing units could appeal to the Department of Local Government Finance to increase the unit's expenditure limit. Grounds for appeal would include annexation, war, new services, transfer of authority from another unit, court order compliance, emergencies that risk injury or death, or an increase in a local option income tax rate. Most local expenditures would be covered by the limits in this proposal except those for capital expenses, transfers, reserves, judgements, and debt service. The new limit would be in addition to the current limits placed on maximum permissible levies and would not apply to school corporations.

Based on historical growth, the appropriations under current law for expenditures included in the proposal are estimated at \$6,238 M in CY 2005, \$6,602 M in CY 2006, and \$6,998 M in CY 2007. Assuming an average CPI increase of 2.5%, under this proposal these expenditures would be limited to \$6,044 M in CY 2005, \$6,189 M in CY 2006, and \$6,338 M in CY 2007. **The limits would result in an expenditure reduction estimated at \$194 M in CY 2005, \$413 M in CY 2006, and \$660 M in CY 2007.** This bill would reduce the expenditures of an estimated 1,382 taxing units out of a total of 2,287 units (double counts cross-county units).

Taxing units that receive more revenue than they may spend under this proposal must use the additional revenue for capital expenditures or deposit the excess into the unit's local rainy day fund. Each unit that has reduced expenditures under this proposal could continue generating the same property tax levy and increase capital expenditures and/or rainy day fund balances. Alternatively, the property tax levy could be reduced if the unit chooses to do so. The fiscal impact of this bill on overall expenditures and property tax levies is dependent on local action. The impact would also change with the change in CPI from year to year.

Explanation of Local Revenues:

State Agencies Affected: All.

Local Agencies Affected: All local civil taxing units.

Information Sources: January 12, 2004, Reserve Statement, State Budget Agency; Bureau of Labor Statistics; Local Government Database.

Fiscal Analyst: Diane Powers, 317-232-9853; Bob Sigalow, 317-232-9859.